2. U.S. GOVERNMENT AGENCY ACTIONS REGARDING ILLICIT FOREIGN PAYMENTS

- Justice Department
- Internal Revenue Service
- Securities and Exchange Commission
- State and Defense Departments

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There are five areas in which the subject of payments by U.S. companies to foreign agents or officials is of immediate interest to the Executive agencies: These are: (1) restraint on competition, (2) corporate disclosure, (3) tax reporting, (4) military sales and assistance programs and (5) U.S. international relations. Based on information gathered for this paper, the concerned Federal agencies are dealing effectively with the problem of illicit overseas payments under the authority they already possess. There is a large measure of cooperation among the agencies. For example, the IRS has been working closely with the Department of Justice and the SEC. Also, the Defense Department works with the State Department with respect to the policies governing the sale of military equipment abroad. None of the agencies has indicated a need for new legislation at this time.

Restraint on Competition

Overseas payments by U.S. companies become an antitrust issue if questions of anticompetitive behavior arise. To the extent that payments by a U.S. company to a foreign official or agent restrain domestic or foreign trade of the United States, it becomes a matter of direct concern to the Antitrust Division of the Department of Justice. Of special concern to the Antitrust Division are the overseas activities of U.S. companies which deny other U.S. businesses the opportunity to compete abroad on a fair and equitable basis. The official viewpoint is expressed by Donald I. Baker, Deputy Assistant Attorney General of the Antitrust Division, who testified that there was no need to introduce new substantive legislation to deal with antitrust enforcement in matters involving foreign payoffs (July 24, 1975, Subcommittee on International Economic Policy of the Committee on International Relations of the House of Representatives).

According to Mr. Baker's testimony, certain payments to foreign agents or officials by U.S. companies do not raise antitrust questions, thus precluding their consideration by the Antitrust Division. These are: (a) payments to a foreign official for "future considerations," to which no specific and immediate benefit can be attributed, (b) payments to a foreign official for the purpose of excluding

the product of a non-U.S. competitor, and (c) payments to a government which are received by a foreign official who in accepting the payment is carrying out his official duties.

In December 1975, the Federal Trade Commission staff recommended that an investigation be launched of the aircraft industry's practices overseas. However, the Commission decided not to go ahead because FTC involvement at this time would duplicate unnecessarily the efforts of other Federal agencies. The Commission, however reserves the right to investigate other cases of foreign payoffs by U.S. companies if such actions "might operate to the detriment of other U.S. corporations or individuals," resulting in a possible restraint of trade under the unfair competition provision (Section 5) of the FTC Act.

Tax Reporting

The Internal Revenue Service investigates various business practices of major U.S. corporations with the purpose of uncovering tax evasion and avoidance and possible misuse of funds through corporate slush funds. Stemming from investigations into the use of domestic corporate slush funds for political contributions, the agency has widened its scope of concern to include slush fund arrangements that involve foreign units of U.S. companies. In this context the subject of overseas payments by U.S. companies is of direct interest to the agency, since it raises the question of illegal business practices (bribery payments) for which corporations may have taken deductions. Section 162(c) of the Internal Revenue Code provides that payments made to foreign government officials as bribes or kickbacks shall not be deductible as ordinary and necessary business expenses.

To facilitate investigation and detection, IRS has issued two new guidelines: one dated August 29, 1975 covers "Corporate Slush Funds" including those involving foreign subsidiaries, and the other, dated December 31, 1974 covers "Political Contributions" including those made abroad. The IRS has greatly intensified its auditing of major corporations' tax returns, by searching on a routine basis for foreign payments that may have been wrongly claimed as business expenses. Secretary Simon considers this action essential for the protection of the integrity of the tax system. If questionable foreign payments are uncovered, special agents from the IRS Intelligence Division are assigned to company

cases to determine if fraud has been committed, whereupon the cases would be turned over to the Justice Department for possible prosecution. The stepped-up enforcement program includes closer coordination of U.S. parent company audits and overseas subsidiary audits. Also, requests for information from foreign tax authorities have been significantly expanded.

Corporate Disclosure

The Securities and Exchange Commission is the lead agency monitoring and regulating the disclosure by U.S. companies of facts of interest to the investing public. In enforcing the federal securities laws, a major concern of the SEC is to assure that corporate information which is important to the potential investor in making investment decisions be disclosed in the corporation's financial reports. Although aware of the possible international consequences of the disclosure of overseas payments, the SEC upholds its mandate to require fair and reasonable corporate disclosure, so as to protect the interests of investors and potential investors in the securities of U.S. corporations. This is based on the right of investors to know if a significant amount of the company's business is dependent on bribes or other illegal activity.

To the extent that overseas payments made by a U.S. company result in the falsification of corporate records or undisclosed misuse of corporate funds (e.g. bribery, political contributions, etc.,), the U.S. company would be in direct violation of the Securities Exchange Act of 1934 (e.g. Sections 13A, 14A or 10B). After initial investigation into a case, civil enforcement actions may be filed with a U.S. District Court to enjoin violation of the Securities Exchange Act of 1934 or of other Federal securities laws. After the issuance of a permanent injunction, any future occurence of such unlawful conduct by the company is punishable as a criminal contempt. Although the Commission has recourse to administrative proceedings in these matters (e.g. by terminating the right of the company to trade or issue securities in interstate commerce) it has refrained from doing so, since they are viewed as "far more damaging to shareholders of the company, who, after all, are innocent victims of the failure to make full disclosure." (June 17, 1975 testimony of Commissioner Philip A. Loomis, Jr. before the Subcommittee on International Economic Policy of the House Committee on International Relations).

The Commission has also implemented a program for voluntary disclosure by companies. By developing specific auditing procedures in consultation with the SEC, a company may acquire a better understanding of the disclosure standards that will meet Federal securities laws and regulations. According to Commissioner Loomis' testimony on July 17, 1975 (before the same Subcommittee for which he made his June 17, 1974 testimony) the Commission is also attempting to develop general guidelines or minimum standards which will assist public companies in identifying types of corporate activity that call for disclosure and will indicate the form in which the disclosure should be made. At the earliest such guidelines or standards will probably be considered after the current proxy season, when corporations submit reports to their shareholders. Up to now, the Commission has relied.on the company's voluntary disclosure of foreign payments. In specific cases that involve foreign payments by a company's top management, SEC at times requires disclosure of foreign payments in proxy statements which will be sent to shareholders before their annual meeting. The Commission believes that such disclosure information would be useful to shareholders before they vote for the company's directors.

In the Lockheed case, the SEC is operating under a court order issued in December 1975, permitting the Commission full access to Lockheed's corporate records provided that 10 days' notice to the Court and to Lockheed is given before SEC discloses the company's records to non-SEC individuals or organizations. Under this court provision, Lockheed is given an opportunity to argue against the disclosure of the company information to the public or non-SEC persons during the 10-day period.

It is expected that the SEC will be issuing a consent decree which would require that Lockheed disclose such payments by the company in the future. In a March 3, 1976 statement of Roderick M. Hills, Chairman of SEC, before the Senate Committee on Banking, Housing and Urban Affairs, the SEC indicated that it is considering the possibility of requiring Lockheed to comply with the "voluntary disclosure" program designed by the SEC (i.e., company must stop all payments to organizations affiliated with foreign governments or to foreign government officials and political parties; must draft company policy guidelines to prevent such payments; and thirdly, must set up procedures to enforce the company's policy on foreign payments). The company would also be

obliged to compile a report on all previous payments activities of the company. In Chairman Hill's statement, SEC approved the current developments by independent auditors to increase their responsibility (and liability) in presenting a true and accurate image of a corporation's financial status.

The SEC has created a new Advisory Committee on Corporate Disclosure to examine the adequacy of current regulations. The Committee is chaired by Commissioner A.A. Sommer, Jr., (who will serve after his resignation from the SEC) and includes academics, financial industry experts and private lawyers. It meets once a month and is due to complete its work by July 1, 1977. One aspect of the work may be developing guidelines for disclosure of overseas behavior. The SEC is also encouraging individual voluntary codes of ethics with direct involvement of outside directors.

To date about 80 companies have admitted foreign payoffs under the SEC's voluntary disclosure program. The volunteers have not been required to disclose details such as names of recipients or countries. The SEC's enforcement division is investigating 10 domestic cases, including instances of kickbacks to retailers by beer and liquor companies and allegations of bribes in the construction industry.

Military Sales and Assistance Programs

The State Department has the primary policy-making role in this general area. The Department of Defense is specifically responsible for implementing the Military Assistance Program and the Foreign Military Sales Program. The economic justification for the inclusion of substantial agent's fees in foreign military sales has been investigated by both Departments. Although such agent's fees are paid by the foreign government purchaser and not by U.S. companies, State has found it necessary to issue proposed new regulations (August 25, 1975) on the subject of contingent fees and commissions governing international arms sales. State's proposal would amend its International Traffic in Arms Regulations (ITAR) to require U.S. exporters to certify that disclosure of contingent fees or commissions exceeding $10,000 on a minimum sales value of $100,000 and of the recipient's identity, has been made to the purchasing government. On the same note, Defense has issued comparable changes to cover sales under the Foreign Military Sales Act which in effect require disclosure to purchasing governments of any agent's fees included in the contract. As viewed by Defense, reasonable agent's fees are legitimate costs since sales agents are sometimes essential in conducting business overseas. These changes in

procedure have been developed, however, to discourage the inclusion of exhorbitant contingent fees and commissions in foreign military sales and international arms sales.

If legislation based on the conference version of the Foreign Military Assistance Act (S. 2662 and H.R. 119633) is enacted, State's proposed new ITAR regulations and DOD's present disclosure procedures on FMS would have to be changed to comply with the Conference report requiring mandatory reporting of agent's fees for both commercial and government military sales.

In its auditing of U.S. government agencies, the General Accounting Office examines government contracts, including foreign military sales, and where disallowed costs have been included, the Office would initiate measures to recover the charges. In a statement by Robert F. Keller, Deputy Controller General of the U.S. General Accounting Office before the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee, (January 15, 1976) the GAO recommended that "to foster public policy against such improper or questionable practices, to deter such practices, and to increase the integrity of the Federal procurement process, the Secretary of Defense amend the Armed Services Procurement Regulation to require that each negotiated Government contract include a clause specifically prohibiting payment of gratuities by sub-contractors to higher tier contractors."

Concerning the overseas payments made by Lockheed Aircraft Corporation, the Emergency Loan Guarantee Board, which is authorized to provide guaranteed loan assistance to major corporations whose failure could seriously affect the economy, decided as a condition of continuing the Government guarantee for Lockheed, to prohibit Lockheed from making any additional payments, directly or indirectly, to foreign government officials and political organizations. (Statement made on September 30, 1975 by Edward A. Schmults, as Under Secretary of the Treasury, on Lockheed Aircraft Corporation's foreign sales activities and Emergency Loan Guarantee Program, before the Subcommittee on International Economic Policy of the Committee on International Relations of the House of Representatives).

International Implications

Foreign payments by U.S. companies raise foreign policy questions including the role to be played by any international code of conduct for multinational corporations. The Department of State and other affected Departments and Agencies have consistently taken in international discussions the position that the United States condemns both the payment of and the solicitation of bribes by foreign private individuals and government officials.

The most recent authoritative statement on the foreign policy aspects of this question is that of Deputy Secretary of State Ingersoll before a Subcommittee of the Joint Economic Committee on March 5, 1976. He made the following points:

1. The U.S. condemns illegal payments and will not protect investors who make them from proper law enforcement actions unless they are treated unfairly.

2. Investors often have to operate under unclear rules, differing local customs and importunities to make sub rosa payments. Businessmen therefore oppose domestic or international legal action but generally would agree that some action is necessary.

3. This is an international problem and significant progress will come only on a broad scale, not unilaterally, as Congress has recognized.

4. "Grievous damage" has been done to the foreign relations of the U.S. through public discussion of alleged misdeeds of officials of foreign governments.

5. As a first step we have negotiated strong language condemning bribery as part of the voluntary guidelines for MNC's being drawn up in the OECD. Next, the U.S. proposes a multilateral agreement on corrupt practices.

6. Such agreement would apply to transactions with governments, and host governments would establish clear guidelines with criminal penalties for bribery. Governments would cooperate and exchange information, and uniform provisions would be agreed for disclosure by enterprises, agents and officials of political contributions, gifts and payments.

7. The U.S. is developing a procedure to facilitate exchanges of information with foreign governments. Under this procedure, the Department of Justice would enter into cooperative arrangements with the responsible law enforcement agencies of other interested governments, as it has done in past cases of interest to more than one government. It will arrange for the exchange of information in accordance with the traditional procedures established to protect the integrity of criminal investigations and the rights of individuals affected. That is, foreign law enforcement officials would be expected to assure that information secured from United States sources would be treated on a confidential basis until such time as the foreign law enforcement agency had decided that it wished to proceed with a criminal prosecution against a particular individual.

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